TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE

FISCAL NOTE

HB 2445 – SB 2573

January 29, 2012

SUMMARY OF BILL: Effective January 1, 2013, phases out the Hall Income Tax over a three-year period consisting of a tax rate reduction from six percent to four percent for tax year 2013, a tax rate reduction from four percent to two percent for tax year 2014, and a tax rate reduction from two percent to zero for tax year 2015 and all subsequent tax years. Holds local governments harmless from the loss of revenue occurring as a result of this bill. Requires any allocations made to local governments due to the hold harmless provision be allocated from the general fund.

ESTIMATED FISCAL IMPACT:

Decrease State Revenue – Net Impact –
$20,818,700/FY12-13
$62,456,400/FY13-14
$104,093,300/FY14-15
$124,912,000/FY15-16 and Subsequent Years

Increase State Expenditures –
$13,196,300/FY12-13
$39,588,800/FY13-14
$65,981,300/FY14-15
Net Impact - $78,699,400/FY15-16 and Subsequent Years

Decrease State Expenditures - $632,700/FY16-17
$709,600/FY17-18 and Subsequent Years

Increase Local Revenue - $496,400/FY12-13
$1,489,300/FY13-14
$2,482,200/FY14-15
$2,978,600/FY15-16 and Subsequent Years

Other Fiscal Impact - Secondary economic impacts may occur as a result of this bill. Such impacts may be realized due to changes in population or as a result of other behavioral changes prompted by passage of this bill. Due to multiple unknown factors, fiscal impacts directly attributable to such secondary economic impacts cannot be quantified with reasonable certainty.

Assumptions:

- The current Fiscal Review Committee estimate for Hall Income Tax collections for FY12-13 is $211,140,000.
- Pursuant to Tenn. Code Ann. § 67-2-102, the Hall Income Tax is a six percent tax on income derived from dividends on stock or from interest on bonds.
- Taxable income in FY12-13 is estimated to be $3,519,000,000 ($211,140,000 / 6.0%). This number is assumed to remain constant in subsequent years.
- The decrease in Hall Income Tax collections for FY12-13 would be approximately $70,380,000 ($3,519,000,000 taxable income x 2.0% rate reduction); for FY13-14 would be approximately $140,760,000 ($3,519,000,000 taxable income x 4.0% rate reduction); and for FY14-15 and subsequent years would be approximately $211,140,000 ($3,519,000,000 x 6.0% rate reduction).
- Given the January 1, 2013 effective date proposed, the first-year (FY12-13) impact is estimated to be 50 percent of the impact estimated for FY12-13 (assuming an effective date of July 1, 2012). Therefore, the decrease in Hall Income Tax revenue for FY12-13 is estimated to be $35,190,000 ($70,380,000 x 50.0%).
- Fifty percent of tax savings for Tennessee taxpayers will be spent in the economy on other sales-taxable goods and services.
- The current state sales tax rate is 7.0 percent; the average local option sales tax rate is estimated to be 2.5 percent. Therefore, an increase in state sales tax revenue of $1,231,650 ($35,190,000 x 50.0% x 7.0%) in FY12-13; an increase in local option sales tax revenue of $439,875 ($35,190,000 x 50.0% x 2.5%) in FY12-13.
- Pursuant to Tenn. Code Ann. § 67-6-103(a)(3)(A), local governments receive 4.5925 percent of all state sales tax revenue as state-shared sales tax revenue. Therefore, an increase in local revenue estimated to be $56,564 ($1,231,650 x 4.5925%) in FY12-13.
- The net increase in state revenue attributable to sales tax collections is estimated to be $1,175,086 ($1,231,650 - $56,564) in FY12-13.
- The total increase in local revenue attributable to sales tax is estimated to be $496,439 ($439,875 + $56,564) in FY12-13.
- Pursuant to Tenn. Code Ann. § 67-2-119(a), the state retains 62.5 percent of Hall Income Tax revenue; local governments are apportioned 37.5 percent.
- Local governments are held harmless from the loss of Hall Income Tax revenue. As a result, there will be an increase in state expenditures from the general fund of $13,196,250 ($35,190,000 x 37.5%) in FY12-13.
- The net decrease in state revenue for FY12-13 is estimated to be $20,818,664 [($35,190,000 - $13,196,250) - $1,175,086].
- Given the January 1, 2013 effective date proposed, the second-year (FY13-14) impact is estimated to be 50 percent (six months) of the impact estimated for FY12-13 plus 50 percent (six months) of the impact estimated for FY13-14. Therefore, the decrease in Hall Income Tax revenue for FY13-14 is estimated to be $105,570,000 [($70,380,000 x 50%) + ($140,760,000 x 50%)].
- The increase in state sales tax revenue due to tax savings being spent in the economy is estimated to be $3,694,500 ($105,570,000 x 50.0% x 7.0%) in FY13-14; the increase in local option sales tax revenue is estimated to be $1,319,625 ($105,570,000 x 50.0% x 2.5%) in FY13-14.

- Incremental state-shared sales tax revenue to local governments for FY13-14 is estimated to be $169,670 ($3,694,500 x 4.5925%).
- The net increase in state revenue attributable to sales tax collections is estimated to be $3,524,830 ($3,694,500 - $169,670) in FY13-14.
- The increase in local revenue attributable to sales tax is estimated to be $1,489,295 ($1,319,625 + $169,670) in FY13-14
- Due to the proposed hold harmless provision, there will be an increase in state expenditures from the general fund of $39,588,750 ($105,570,000 x 37.5%) in FY13-14.
- The net decrease in state revenue for FY13-14 is estimated to be $62,456,420 [($105,570,000 - $39,588,750) - $3,524,830].
- Given the January 1, 2013 effective date proposed, the third-year (FY14-15) impact is estimated to be 50 percent (six months) of the impact estimated for FY13-14 plus 50 percent (six months) of the impact estimated for FY14-15. Therefore, the decrease in Hall Income Tax revenue for FY14-15 is estimated to be $175,950,000 [($140,760,000 x 50%) + ($211,140,000 x 50%)].
- The increase in state sales tax revenue due to tax savings being spent in the economy is estimated to be $6,158,250 ($175,950,000 x 50.0% x 7.0%) in FY14-15; the increase in local option sales tax revenue is estimated to be $2,199,375 ($175,950,000 x 50.0% x 2.5%) in FY14-15.
- Incremental state-shared sales tax revenue to local governments for FY14-15 is estimated to be $282,818 ($6,158,250 x 4.5925%).
- The net increase in state revenue attributable to sales tax collections is estimated to be $5,875,432 ($6,158,250 - $282,818) in FY14-15.
- The increase in local revenue attributable to sales tax is estimated to be $2,482,193 ($2,199,375 + $282,818) in FY14-15.
- Due to the proposed hold harmless provision, there will be an increase in state expenditures from the general fund of $65,981,250 ($175,950,000 x 37.5%) in FY14-15.
- The net decrease in state revenue for FY14-15 is estimated to be $104,093,318 [($175,950,000 - $65,981,250) - $5,875,432].
- Beginning in FY15-16, the recurring decrease in Hall Income Tax revenue is estimated to be $211,140,000.
- The recurring increase in state sales tax revenue due to tax savings being spent in the economy is estimated to be $7,389,900 ($211,140,000 x 50.0% x 7.0%) beginning in FY15-16; the recurring increase in local option sales tax revenue is estimated to be $2,639,250 ($211,140,000 x 50.0% x 2.5%) beginning in FY15-16.
- The recurring increase in state-shared sales tax revenue to local governments is estimated to be $339,381 ($7,389,900 x 4.5925%) beginning in FY15-16.
- The net recurring increase in state revenue attributable to sales tax collections is estimated to be $7,050,519 ($7,389,900 - $339,381) beginning in FY15-16.
- The recurring increase in local revenue attributable to sales tax is estimated to be $2,978,631 ($2,639,250 + $339,381) beginning in FY15-16.
- Due to the proposed hold harmless provision, there will be a recurring increase in state expenditures from the general fund of $79,177,500 ($211,140,000 x 37.5%) beginning in FY15-16.

- The net recurring decrease in state revenue beginning in FY15-16 is estimated to be $124,911,981 [($211,140,000 - $79,177,500) - $7,050,519].
- Given that tax rate reductions will not reduce the number of tax returns filed in the first two years, there will be no expenditure savings associated with the bill until the Hall Income Tax is eliminated. The first year in which the Department of Revenue (DOR) would be able to begin eliminating positions will be in FY15-16. In FY15-16, DOR will be able to eliminate 10 positions from the Processing Division and two positions from the Audit Division. The decrease in state expenditures associated with the elimination of these positions is estimated to be approximately $478,100. Therefore, the decrease in state expenditures for FY15-16 will be $478,100. In FY16-17, DOR will be able to eliminate an additional three positions from the Audit Division. The decrease in state expenditures associated with the elimination of these three positions is estimated to be $154,600. Therefore, the total decrease in state expenditures for FY16-17 is estimated to be $632,700 ($478,100 + $154,600). In FY17-18, DOR will be able to eliminate two final positions from the Audit Division. The decrease in state expenditures associated with the elimination of these two positions is estimated to be $76,900. Therefore, the total recurring decrease in state expenditures beginning in FY17-18 is estimated to be $709,600 ($478,100 + $154,600 + $76,900).
- The increase in state expenditures associated with the hold-harmless payment to local governments for FY15-16 will be offset by the decrease in state expenditures associated with staffing reductions, which begin in FY15-16. Therefore, the net increase in state expenditures for FY15-16 is estimated to be $78,699,400 ($79,177,500 - $478,100)
- There could be subsequent increases in state and local government revenue and expenditures due to secondary economic impacts prompted by passage of this bill. Increases in revenue may occur if the state's population increases as a result of a reduced tax liability. Increases in expenditures may occur if the demand for governmental programs and infrastructure increase as a result of population increases. Due to multiple unknown factors such as the extent and timing of population changes, the fiscal impacts directly attributable to such secondary economic impacts cannot be quantified with reasonable certainty.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.

Lucian D. Geise, Executive Director

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